for their greater degree of risk. These risk factors include, among others, the possibility of localized economic downturns, smaller economic bases, natural disasters, loss of key personnel, greater exposure to regulatory uncertainties and expenses, less access to capital, and a host of other factors.

For rate of return calculations, Small Cities suggests that the size of a company or ownership unit rather than its individual systems, should be the operative unit, since it is on the basis of operating incomes which roughly parallel these numbers that financing is obtained. Small Cities recommends that differing rates of return be established for independent companies of up to 1,000 customers, 2,500 customers, 5 thousand, 10 thousand, 25 thousand, 50 thousand, 100 thousand and on up to one-half million. Small Cities suggests that rates of return be set according to either subscriber numbers (as above) or to total invested capital (debt plus equity) of $5 million or less, $5 to $10 million, $10-25 million, $25-50 million, and $50 million or more. The Commission should know that many banks will not finance deals smaller than $5 million of senior debt and an even greater number will not touch deals of less than $10 million. The Commission can consult directories from Paul Kagan & Associates and other sources for such information.

Comments: Small business entrepreneurs have wired the most rural parts of the U.S., many of them only since rate regulation was lifted. Small, independent companies created by entrepreneurs built the cable tv business starting in the 1950's. Most recently, small companies have extended to many outlying areas shunned by bigger operators.

It would be grossly unfair for the Commission to overlook this history and allow small companies with only a few thousand customers who are considered small by the Small Business Administration, only to receive the same rate of return as the biggest with millions of customers.

Should the Commission adopt a single-rate of return policy it will put smaller, independent companies and those serving rural areas at a serious disadvantage in the marketplace for capital. This, in turn, would hasten the concentration of the cable business which the Act found to already be highly concentrated. And it would reduce the number of media voices in the market place.

Comments: Rural telephone company regulation offers precedents for higher rates and other special considerations for companies doing business in rural areas. The history of higher rates and cheaper capital for rural telephone business suggests that the Commission would be correct in granting a company size-related rate-of-return premium for smaller companies. Rural telephone companies have typically been allowed to charge both higher rates than their urban counterparts, and they have had access to below-market-rate sources of capital to finance their expansion. The needs for both are none-the-less true for rural cable operators. Without both reasonably higher rates and access to capital, many companies will disappear. Here the Commission appears poised to adopt an inverted approach that would seriously affect small operators.

If the record of comments in this proceeding is insufficient, Small Cities recommends that the Commission employ its information-gathering authority to investigate the differential rates of return projected in both public and private placements in the last six, twelve, eighteen and twenty-four months and to gather information from investment bankers and other sources such as Paul Kagan and Associates.

Small Cities also offers a cautionary note about the smallest cable companies, those independents with capitalizations of $5 million or less. These companies, like ours, are less commonly serviced by investment bankers or reported in the trade press. Like many such companies, the Small Cities Cable Television Limited Partnership was financed through a private offering. After obtaining the franchises, the General Partner hired a law firm to prepare the offering. He personally wrote the business plan, sold the limited partnership units totalling $900,000, made presentations to lenders, guaranteed $1.5 million in loans, and started the company. In the process I invested my life savings and invested enormous sweat equity over a period of five years before the Small Cities partnership was created and initiated service. In more than eight years since the company was formed, partners have received only one cash payout totalling $30,000, in 1992. This represents the equivalent of four-tenths of one percent per year.

The General Partner's sweat equity was compensated with a contingent equity interest dependent on partners receiving disbursements equal to their initial investments. This payout has not yet happened. The **General Partner** still therefore **owns only 1%** of the company **but carries unlimited personal liability**.

These profits are by no means unreasonable.

Comments: Sources of information on appropriate rates of return for cable companies of varying sizes. Regional bankers, venture capital companies specializing in cable, and brokers are the most likely source for such information. Kagan Associates publishes an annual financial directory for the cable tv business. One way to evaluate the differential might be to determine how much more, on average, small companies pay for their bank debt than top 10 MSO's, and how this amount differs from the average cost of capital of those companies. (Veronis-Suhler & Associates reports some of this data in an annual publication on the largest companies.)

Paragraph 47: How should the FCC balance the goals of protecting consumers and allowing the economically justified expansion of cable infrastructure.

Comments: Small Cities will comment on rural areas, those with fewer than 40 homes or 30 cable subscribers per mile.

We propose that the FCC examine the cost of purchasing a typical C-Band TVRO satellite dish with debt on a home equity loan, maintaining, depreciating, and providing programming for it comparable to rural cable service, all for the ten years prior to this proceeding. This examination, described below, gives some indication of what millions of rural residents consider to be "reasonable rates" for programming equivalent to cable service.

Millions of home TVRO satellite dish owners have voluntarily spent **more than $79.00 per month to own and receive programming on dishes which may soon be obsolete, a far, far higher figure than any company charges its subscribers**. This suggests that, at least for rural areas, the Commission's assumption that current charges are unreasonable is, in itself, invalid.

Small Cities Cable serves primarily rural areas where dishes were common before our service was installed. In these areas, some of our best customers have been those who owned or still own C-Band satellite dishes. They typically invested

$2,000 for a TVRO dish and receiver. When scrambling began prohibiting them from stealing channels, in most cases they started paying at least $30 per month for cable service.

The economics of home dish ownership are as follows: If a consumer used a home equity loan to purchase the dish, it would, between 1983 and 1993 have had an average cost of perhaps 12%.

With a 10-year depreciated life at these rates, the consumer cost is $950 per year, or $79.16 per month, including repair service at $12.50 per month (7.5% of acquisition price). If an entrepreneur leased the dish to consumers', they would receive an annual cash-on-cash return of 47.5%, but a pre-tax income of only 11.5%. That few dishes were or are leased to consumers under arrangements similar to this shows that this is an unattractive rate of return.

Because they know the true costs of receiving satellite programming, dish owners were often the first to sign on with us when we extended to their homes in the past. They know the value of cable tv where the cable company, not the consumer, invests upfront in reception equipment, maintains the system, and charges far less per month than the cost of owning a dish. <u>We therefore propose a rate of return of 15%-20% would be justified in rural areas, not accounting for risk factors inherent in installing fixed plant and other factors</u>.

After launch this fall and introduction in 1994, DBS dishes from Hughes Direct TV will cost consumers $700, plus monthly programming costs, maintenance, depreciation, etc. Cable companies typically invest two or more times that amount per subscriber to serve an area.

Small Cities proposes that the Commission examine the average costs of owning, maintaining, and depreciating a C-Band TVRO over the last decade and receiving programming comparable to what rural cable companies offer in order to set an acceptable rate of return, for small companies and to take another look at the benchmark pricing system. If the above calculations are correct, rural cable companies may, in fact, be charging prices which are actually far lower than is "reasonable" according to what consumers are willing to pay.

<u>Paragraphs 51-53</u>: Cost of Capital, Including Both Equity and Debt, is far higher for small companies.

<u>Comments</u>: Small cable companies are severely limited as to the forms of capital they have available, to its amounts, and its costs. We have been recently told that a 20% cash-on-cash return would be required to attract equity in today's market for smaller companies. Small Cities experience has found that senior bank debt (if and when available) costs small companies between 1.25% over prime rate, to as much as 4% over, with subordinate debt starting at the upper end of that range. We have been told that, in view of the current uncertainty surrounding the future of the cable business, bank lenders are currently not making new loans. Therefore our existing, embedded debt is the only debt we are likely to have access to.

Comments: FCC should allow for variable interest rates which could again reach double-digit levels: Like many other smaller companies, Small Cities debt rate is set at a variable rate of prime plus an added amount. When the company was in planning stages during 1983 and 1984, the interest rates we were quoted by lenders exceeded 20% per annum. Should the prime rate again soar, companies must be protected against cost-squeeze defaults.

The Commission should therefore establish a system to assure companies' ability to service their debt during periods of higher interest rates under its cost-of-service regime.

In view of this fact, we suggest that the Commission:

1. Establish a mechanism which allows interest rate variability to be reflected in rates when interest costs exceed a set threshold.

2. Take into account the higher cost of interest by smaller companies and allow them to reflect these costs in their cost-of-service showings.

<u>Paragraph 56</u>: Should FCC use an investment cycle approach to measuring rate-of-return?

<u>Comments</u>: The Commission should be aware that many financial players who purchased, briefly held, and sold cable systems in the 1980's during the Leveraged Buyout era have now departed the business. Retrospective studies with an investment cycle approach might be skewed by this history. To the extent that this approach might envision a repeat of huge, speculative profits as occurred in the 1980's on the sale of small companies, it could cause damage to smaller companies today by forcing their rates below present economic cost. Such profits are unlikely to occur again soon.

<u>Paragraph 68</u>: Transactions between cable operators and affiliates.

<u>Comments</u>: We comment on the above as it relates to <u>management fees</u> and propose that the Commission allow such fees based on a showing that comparable fees were usual and customary among third parties at the time the agreement under which they are provided was created, thus establishing a credible arm's length transaction price.

Small Cities also encourages the Commission to expressly allow non-regulated affiliates to sell cable equipment such as wire, converters, splitters, etc. and not have those revenues or profits regulated as part of the core business by being deducted from their benchmark rates. This would allow cable companies to encourage the use of quality equipment in customers homes.

Consumers will still be free to purchase wiring and equipment elsewhere. However, cable companies will still be required to meet signal leakage requirements for customers' homes where they have installed their own drop materials, fittings, etc. If cable operators must deduct their equipment sales revenues from service rates under the benchmark system, they will be forced to send their customers to others to purchase equipment. As a result, customer-initiated signal leakage may become a major problem for operators.

Question: WHAT STREAMLINING ALTERNATIVES SHOULD THE COMMISSION EMPLOY?

Paragraph 72: The use of key cost factors

Comments: One potential use of a key factors system would be for the Commission to establish benchmark costs for items such as costs of capital, programming, personnel, employee benefits, power and pole rentals. Companies whose costs exceeded these levels would be permitted to charge benchmark plus "add-ons" as mentioned in the proposed rules.

Paragraph 74: FCC should encourage creation of a Cable Cost Advisory Program ("CCAP") to develop average cost data and support cost of service showings by smaller companies.

Comments: Small Cities recommends that the Commission encourage the establishment of a self-supported system, a Cable Cost Advisory Program (CCAP) for the cable industry similar to the NECA model for regulating small Local Exchange Companies in the telephone business. The CCAP Association would be responsible for collecting average cost data and presenting it to the Commission staff in support of Cost of Service showings by companies. CCAP would have particular responsibility for investigating costs of companies of differing sizes to avoid unintentional penalties against and burdens on smaller companies, those serving higher cost areas and specialized circumstances.

Paragraph 75: **The FCC should establish an abbreviated cost-of-service showing for significant prospective capital expenditures used to improve quality of service or to provide additional services.**

Comments: It is doubtful that benchmarks reflect these costs because they are not truly cost-based. An abbreviated showing for significant prospective capital costs is therefore desirable.

Streamlining for Small Systems: Employ a "NECA-type" Cable Cost Advisory Program ("CCAP") as described above to serve as an expert source of cost information and advocacy for small companies as well as small systems.

We encourage the Commission to establish a mechanism or panel which would investigate the costs of providing service to small systems, and by small companies who have more than 1,000 subscribers but less than $7.5 million in total revenues (or a higher number as established by the FCC). (The National Exchange Carrier Association, "NECA", established by the FCC [see 47 C.F.R.§69.601] could serve as a model.) The results of this panel's work could be published for comment and used as the basis cost-of-service formulae for different areas ("pools" in NECA terminology) of the country. If a particular system's costs in one or several areas were greater than area averages by a certain amount such as 5%, it could apply to have those costs added to its rates.

<u>Paragraph 77</u>: FCC should exempt systems with densities of less than 30 subscribers per mile (regardless of number of subscribers) and 1,000 subscribers upon initiation of the first DBS service available to 50% of the households in the area and offering a minimum number of channels of cable-type programming.

<u>Comments</u>: The upcoming availability of DBS service will further convince most rural cable customers that they are not currently paying unreasonable prices. In view of this fact, the Commission could establish density, total size per franchise, and total holdings per company standards which would exempt small systems and companies from price regulation.

__Paragraph 78__: **What definition of small systems should be used for Cost-of-Service purposes? FCC should utilize the Small Business Administration Definition of a small cable company in its rulemaking and design implementation strategies accordingly.**

__Comments__: The Small Business Administration's definition of a small cable television business is one with annual gross operating revenues of less than $7.5 million.

Small Cities encourages the Commission to, at the very least, directly utilize the SBA definition in lieu of its own determination. However, as the guardian's of the nation's telecommunications infrastructure, we believe it is incumbent on the Commission to establish a definition which is substantially higher than the SBA's, supported by reliable data, to avoid seriously disadvantaging small companies and possibly forcing many out of business.

__Paragraph 79__: **Should the Commission use an average equipment cost system and set allowable costs based on this system?**

__Comments__: Because we are a small independent company, Small Cities assumes that we pay significantly higher prices for equipment, and for repair services for that equipment, than do the biggest MSOs. An average equipment cost system would discriminate against us because we may be forced to pay more than that average cost.

We caution the Commission that because discounts are commonly given for simultaneous purchase of several types of gear (ie. head end equipment, line electronics, converters, etc.), actual prices paid may be difficult to determine without examination of vendor's books. We therefore suggest that the Commission use its information-gathering authority to examine the books of those vendors as the most efficient, accurate method of determining equipment costs. An appropriate audit of the major equipment vendors, based on order size, company size and range of items ordered could produce desired data quickly.

Comments: A flaw exists in the current benchmark system regarding equipment costs: While the Commission has stated its intention to reduce cable rates by 10%, under its proposed regulations and their accompanying worksheets, companies are required to deduct their equipment costs before making that 10% deduction. As a result, companies who have already unbundled their equipment costs (as Small Cities has under encouragement of franchise authorities) would see their rates reduced far more than 10% under the benchmark system.

Paragraph 80: Cost Studies

Comments: We applaud the Commission's plan to conduct cost studies of the cable industry in depth through the Mass Media Bureau. As stated previously, we encourage the Commission to set up an industry-backed entity (like NECA) to work in conjunction with the Bureau. In particular, we suggest that the Commission examine:

1. Cost differentials between large and small companies, giving particular attention to costs for the biggest companies and for those defined as small by the Small Business Administration (ie. less than $7.5 million in revenues).

2. Costs (both direct and indirect) of systems in competitive markets. Particular attention should be given to subsidization by parent companies, municipalities, and other sources.

Small Cities believes that many competitive cable systems may be losing money: This belief comes from experience. A company affiliated with Small Cities owns a small cable system which faces significant competition as defined by the Commission. This company has fairly recently initiated service. It is losing money. It is virtually certain that the competing company is also losing money.

We submit that if this system is representative of others in competitive situations in the Commission's sample, the benchmark rates derived from its research are invalid. This is because median prices for competitive systems were used to determine the benchmarks. If any significant number of the systems studied were losing money, the allowable benchmark rates would be set at or near losing levels.

If the Commission has set benchmark rates at or near losing levels, or at levels which have been effectively subsidized by municipalities, MSO's or others with uncommon cost structures, the FCC will cause grievous and possibly lasting harm to the cable communications business in the U.S. This would have serious consequences for the competitiveness of our country.

Paragraph 88: Collection of Information, form Schedule 2, Appendix B

Comments:

1. Add electric power costs:

a. To include local/regional factors which may differ: As an operator in New England, where electricity rates are among the highest in the nation, Small Cities recommends including electricity as an additional line item. In 1992 our electricity costs were to $.48 per subscriber per month, not counting the expense of power for computers and other equipment located in our office where we pay rent including electricity. Other areas may pay significantly less.

b. To avoid inadvertently discouraging the adoption of new technologies which eliminate the need for converter boxes in subscriber's homes. A company which is affiliated with Small Cities has installed so-called "interdiction" technology which is the equivalent of converter boxes "off-premises". Instead of drawing electricity for their operations from subscriber's homes, these boxes draw it through the cable system, resulting in higher electricity costs. Unless electricity costs are separately reported and allowed, cable companies would be placed at a cost disadvantage if they deployed such customer-friendly equipment in their systems. This runs contrary to the Cable Act's intent.

2. Commission should collect data on the number of poles for which rental is paid: This will allow the Commission to compare pole rental costs by state, region, etc. As the attached graph (Small Cities Appendix A) from the New England Cable Television Association shows, there are wide disparities between pole rental cost averages by state, with Vermont being the highest in the nation at $12.18 average annual rent per pole, compared to only $4.24 nationwide.

Because of low subscriber density and high pole rental rates, Small Cities pays <u>$.38 per subscriber per month</u> in pole rental fees alone. The Commission should collect comparative data on this in order to be able to provide relief where appropriate.

3. FCC should ask for the number of plant miles in service, miles added during the last year, and number of average subscribers per mile: This will help the Commission determine differences in costs between low and high-density operators. Since these figures will change little from year-to-year, they should not be onerous to file except for systems of fewer than 1,000 subscribers.

4. A line breaking out costs of non-operational regulatory compliance should be added to the form in order for the Commission to monitor the impact of its work on cable companies and consumers.

5. Line 15: Meaning of "Payments to Pay Cable Program Supplies" is unclear: Does the Commission mean payments to premium (ie. "pay") services like HBO? Does the Commission mean regulated programming as a whole? Small Cities suggests that the FCC should have a mechanism to monitor payments for regulated programming, including both satellite-received channels and payments/compensation for retransmission consent, in order to determine how these amounts compare between large and small companies.

This data must be collected in such a way as to avoid placing the cable industry under an unfair disadvantage in an increasingly competitive marketplace.

6. This request may create significant burdens on operators of systems of fewer than 1,000 subscribers, and those who do not have annual certified audits. Small companies should be compensated for their compliance costs, and have those costs allowable in their rate base.

Small Cities suggests exempting small systems and companies except those selected from an annual random sample of systems to be studied by either Commission staff, or preferably, by a new organization which surveys costs of small cable companies comparable to the National Exchange Carrier Association established at the behest of the FCC by smaller telephone companies. If the FCC conducts its own studies, those small systems surveyed each year should, under the regulations, be fairly compensated for the total reasonable costs of compliance with any studies in which it is included. This is because any such requests are likely to be burdensome for the smallest companies since a 1,000 subscriber system is likely to be operated by no more than about two full-time equivalent persons.

Without compensation, this requirement could be burdensome, causing direct personal and financial harm to the systems, significantly detract from the service provided to their customers, or result in faulty or incomplete data generated by the inability of the respondents from fully complying with requested information.

7. FCC should not initiate reporting requirements on changes in ownership. Franchise authorities are and should be the sole repositories of this information. Telephone companies do not, to our knowledge, report such information and therefore neither should cable television companies.

Response to Initial Regulatory Flexibility Act Analysis

a. Administrative Burden reduction provided to small cable businesses in the proposed rules is not significant.

In its draft rules, the Commission has proposed minimal reduction of administrative burdens for small cable systems, following the Cable Act's requirement that administrative and compliance burdens be reduced for small "**systems**". However, in reality the rules actually treat small systems virtually the same as others because they have required owners to conduct identical calculations under the benchmark and price-cap system to determine whether or not they must apply for cost-of-service approval. Since the franchise authority overseeing Small Cities requires the information requested on a consolidated basis for both of our systems, the proposed rules still increase our administrative burden for the smaller system.

b. Proposed rules do not give relief to small companies.

While giving some attention to small "systems", the Commission has thus far been silent on its definition of small "companies" and its actions to take their situation into consideration.

Small Cities is a small, independent company which is treated the same as a big company under the proposed rules. Small Cities has a smaller staff and lower revenues than many, if not most McDonald's fast-food franchises. Yet we are treated under proposed rules as if we were one of the biggest public corporations in the business, like a dominant company with millions of subscribers.

Our rates taken in total are comparable to those of Adelphia Cable Communications, which is the dominant cable company in Vermont where we operate, and the tenth largest in the U.S. Adelphia has a far higher subscriber density than Small Cities in the Burlington area where we both operate. Despite big differentials in size and costs, Small Cities rates are comparable. As a result, our franchise authority has recently found them to be reasonable.

c. FCC should utilize the Small Business Administration's definition of a small cable company in its rulemaking, or establish its own definition in line with economic realities, and design implementation strategies accordingly. The Small Business Administration's definition of a small cable television business as one with annual gross operating revenues of less than $7.5 million.

Small Cities encourages the Commission to, at the very least, directly utilize the SBA definition in lieu of its own determination. However, as the guardian's of the nation's telecommunications infrastructure, we believe it is incumbent on the Commission to establish a definition which is substantially higher than the SBA's, supported by reliable data, to avoid seriously disadvantaging small companies and possibly forcing many out of business.

Because it has focused only on the small system definition stated in the Cable Act, the Commission has not complied with Small Business Act (Section 2) requirements. The Act defines a small business as one that is independently owned and not dominant in its field.

Reporting, record-keeping and other compliance requirements will be burdensome for small companies under the proposed rules. This is because we have limited staff to manage and operate our business.

In the past Small Cities has maintained books and records according to Tax Basis accounting methods as a cost-saving measure. Under the proposed rules we will be required to maintain two sets of books. This would result in a doubling of our financial record-keeping, with no benefit to subscribers or to the business.

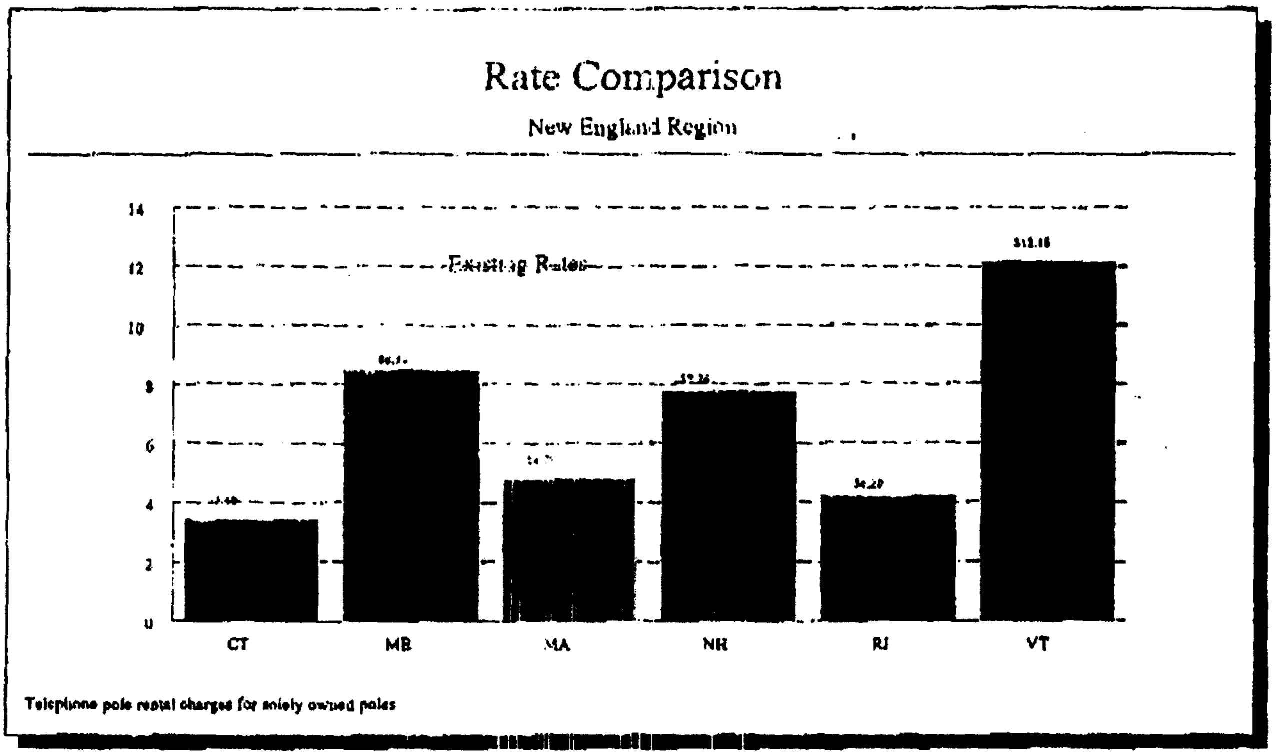
Respectfully submitted,

SMALL CITIES CABLE TELEVISION,
A VERMONT LIMITED PARTNERSHIP

By: ______________________
Paul J. Growald
General Partner

August 25, 1993

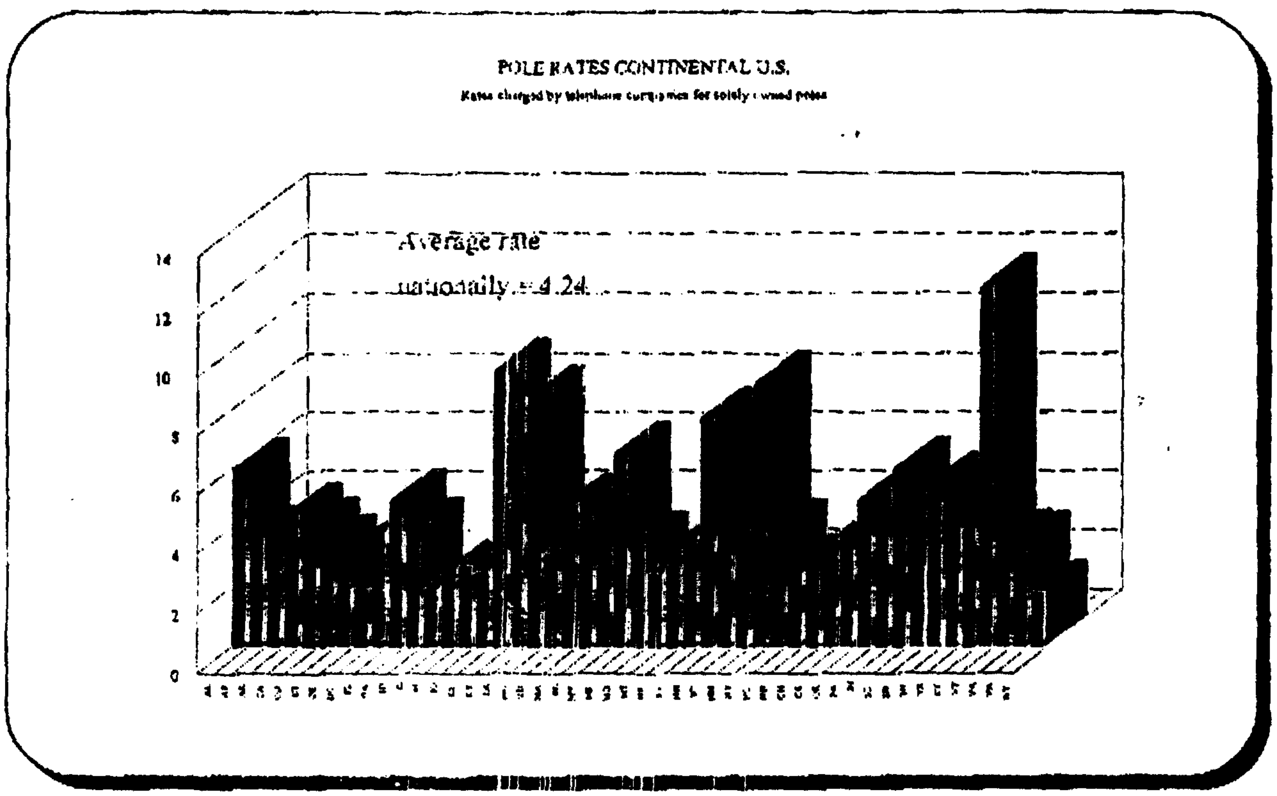
The six New England states rank as follows:



Of the six New England states, three (Rhode Island, New Hampshire, Massachusetts) use some version of the FCC formula. Rhode Island and New Hampshire are FCC states and Massachusetts adopted a variation of the FCC formula by statute. Vermont adopted its own formula with presumptions far less favorable to the industry and currently has the highest pole rates in the nation. The Maine PUC refused to adopt the FCC formula and the New England Telephone rate was a negotiated settlement which started at $7.00 and will reach $9.00 by the end of this year. The PUC staff in Maine had argued in favor of a $25 pole rate. We have legislation on file in Maine to adopt a version of the FCC formula by statute.

The SNET approach of focusing on regional comparisons is faulty for two reasons. First, setting rates by comparing average rates in other jurisdictions is not an accepted or even legal method of rate setting. Second, SNET's focus on regional averages rather than national data distorts reality.

A look at national rates paints another picture.



As the above graph indicates, the average rate charged for a solely owned telephone attachment is $4.24. If we compute the rate as the DPUC did in the last docket (our proposed rate + SNET rate divided by 2) we get a rate closer to the national average (2.78 + 8.00 = 10.78 / 2 = 5.39) of $4.24.

A rate of $5.39 would still represent a 59% increase -- which is why we plan to strenuously argue for the FCC formula.